



Money Talks

BY JOSHUA E. KEATING | MARCH/APRIL 2010

Andrew Card, former U.S. President George W. Bush's chief of staff, once used an **unfortunate business metaphor** -- "you don't introduce new products in August" -- when discussing the Bush administration's public push to invade Iraq. His quote soon became infamous, but looking at war as a financial product does reveal some interesting things about the geopolitical risks involved. Writing in the journal *Economica*, Justin Wolfers and Eric Zitzewitz examined the "**Saddam Security**," an unusual commodity that was traded on an online betting exchange called TradeSports.com in late 2002 and 2003. Because the security only paid out if Iraqi leader Saddam Hussein were removed from office by June 30, 2003, its trajectory can be used as a good proxy for the perceived likelihood of U.S. military action against Iraq during this period. Tracking oil prices and the stock market, researchers found a close similarity: A 10 percent increase in the likelihood of war, as measured by the Saddam Security, correlated with an average \$1 increase in oil prices and 1.5 percent decline in the S&P 500. Clearly, investors were expecting an oil spike and an economic downturn in the event of war. (Both outcomes happened, though not nearly to the extent that the markets indicated.)

From this one example, it's not clear whether the market's assessment of the risk was wrong or the world just got lucky. This was the first explicit attempt to use prediction markets to understand the economic consequences of geopolitical actions, and clearly more study is required. The U.S. government's own attempts to harness the wisdom of

the crowd -- such as the Defense Department's ultimately scuttled "**terrorism futures market**" -- have been politically radioactive. But Wolfers and Zitzewitz argue that the markets are already speaking on security matters, so the world might as well figure out what they're saying.

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